FILED
NOV 13 1950
CHARLES ELMORE CROPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 407

FARMERS' UNION EDUCATIONAL AND COOPERATIVE ASSOCIATION OF SOUTH DAKOTA, AND JUNIOR CHAMBER OF COMMERCE OF MITCHELL,
Petitioners,

vs.

NORTHWESTERN BELL TELEPHONE COMPANY,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF SOUTH DAKOTA

CARL W. BERDAHL,
300 Independence Avenue, S. E.,
Washington, D. C.;
JOSEPH ROSSER, JR.,
Mitchell, South Dakota,
Attorneys for Petitioners.

INDEX

	Page
Opinions below	1
Jurisdiction	2
Questions Presented	2
Statement of the Case	4
Specification of Errors to be Urged	11
Reasons for Granting the Writ	12
(a) The Public Utilities Commission was not required by the due process clause to accept the company's separations procedures, which were not based upon South Dakota experience, and which in the commission's judgment placed an unfair burden upon the users of intrastate telephone services in South Dakota	13
(b) The Fourteenth Amendment does not require the Public Utilities Commission to allow the excessive depreciation reserves accrued by the Company as current expenses	15
(c) The Due Process Clause does not require the Commission to allow as current expenses the excessive accruals of pension reserves	18
(d) The Fourteenth Amendment does not require the Commission to accept, for rate making purposes, the "license contract" payments to the American Telephone and Telegraph Company	19
(e) Since Northwestern failed to sustain the burden of proving that the payments for equipment to Western Electric were proper, the Commission had a right, under the Due Process Clause, to eliminate the excessive profits of that company from Northwestern's rate base and operating expenses	20
Conclusion	22

CITATIONS

	Page
Abie State Bank v. *Bryan*, 282 U. S. 765	13
Coleman v. *Miller*, 307 U. S. 433	13
Colorado Interstate Gas Co. v. *Federal Power Commission*, 324 U. S. 581	15
Columbus Gas & Fuel Co. v. *Public Utilities Commission*, 292 U. S. 398	20
Dayton Power and Light Co. v. *Public Utilities Commission*, 292 U. S. 290	20
Knoxville v. *Knoxville Water Co.*, 212 U. S. 1	22
Lindheimer v. *Illinois Bell Telephone Co.*, 292 U. S. 151	15, 16, 17
St. Joseph Stockyards Co. v. *United States*, 298 U. S. 38	22
Smith v. *Illinois Bell Telephone Co.*, 282 U. S. 133	15, 20
State Tax Commission v. *Van Cott*, 306 U. S. 511	13
Western Distributing Co. v. *Public Service Commission of Kansas*, 285 U. S. 119	20, 22

Document

"Report of the Federal Communications Commission of the Investigation of the Telephone Industry in the United States," *House Document No. 360*, 76th Cong., 1st Sess.	17

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1950

No. 407

FARMERS' UNION EDUCATIONAL AND COOPERATIVE ASSOCIATION OF SOUTH DAKOTA, AND JUNIOR CHAMBER OF COMMERCE OF MITCHELL,

Petitioners,

vs.

NORTHWESTERN BELL TELEPHONE COMPANY,

Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF SOUTH DAKOTA

Petitioners, Farmers' Union Educational and Cooperative Association of South Dakota, and Junior Chamber of Commerce of Mitchell, pray that a Writ of Certiorari be issued to review the judgment of the Supreme Court of South Dakota, a state court of last resort, entered in the above case on July 10, 1950.

Opinions Below

The opinion of the Supreme Court of South Dakota is not yet officially reported. It is unofficially reported at

43 N.W. 2d 553. The opinion appears in the record at pages 354 to 382.[1] The opinion of the Circuit Court of Charles Mix County, South Dakota, which is not officially reported, is set forth in the record at pages 202 to 260. The findings, opinion, and order of the Public Utilities Commission of South Dakota, not officially reported, are set forth in the record at pages 54 to 111.

Jurisdiction

The jurisdiction of this Court is invoked under Section 1257(3) of Title 28, United States Code (Act of June 25, 1948, Ch. 646, § 1257(3), 62 Stat. 929).

Questions Presented

1. In an application for an increase of its rates for intrastate telephone services in South Dakota, Northwestern Bell Telephone Company claimed as operating expenses all of the amounts paid to American Telephone and Telegraph Company, the owner of all of the stock of Northwestern. It appeared that the entire cost of American is allocated to its various wholly owned or controlled subsidiaries. Northwestern refused to show what, if any, portion of American's expenses are incurred in the actual intrastate operations of Northwestern in South Dakota. Does the due process clause of the Fourteenth Amendment to the Constitution of the United States require the South Dakota Public Utilities Commission to include such payments as operating costs of Northwestern in determining whether the rate increase applied for is necessary to afford Northwestern a fair return?

---

[1] The record is not yet printed. The formal papers are numbered from pages 1 to 599. Whenever a reference is made to such papers, they will be cited herein as Record. The transcript of testimony and exhibits before the Public Utilities Commission will be cited herein as *Commission's Transcript.*

2. American Telephone and Telegraph Company conducted a cost survey for the purpose of allocating costs between intrastate and interstate telephone services. The cost survey was made in seven states in 1934, and in two additional states in 1938. From this cost survey, a separations formula was devised by American, and from this statistical result, Northwestern was instructed as to the allocations between its intrastate and interstate operating expenses in South Dakota. Does the due process clause of the Fourteenth Amendment to the United States Constitution require the Public Utilities Commission to accept the separation of operating expenses thus determined, despite the fact that none of the states in which the cost survey was conducted are similar in operational characteristics to South Dakota, and despite the fact that plant value and revenues received indicate that a higher proportion of the costs should be allocated to interstate business?

3. Northwestern Bell Teelphone Company adopted as an accounting method a straight-line method of depreciation, its depreciation rates being based upon estimated service value and service life. Its depreciation accruals exceed the actual retirements of plant and equipment to such an extent that its present depreciation reserve balance was equal to 39.46 per cent of its book cost of the depreciable plant. Does the due process clause of the Fourteenth Amendment to the United States Constitution require the Public Utilities Commission to allow all of the depreciation accruals as a current operating cost in considering the company's application for increased rates?

4. Northwestern Bell Telephone Company purchases its equipment from Western Electric Company. Like Northwestern, Western Electric is wholly owned by American Telephone. The record showed that Western Electric has earned grossly excessive profits. Does the Fourteenth

Amendment to the United States Constitution prevent the Public Utilities Commission from excluding such excess profits in its calculation of plant value and operating expenses in determining rates for Northwestern's intrastate services in South Dakota?

5. In providing for its operations, Northwestern has adopted, under instructions from American Telephone and Telegraph, a pension system under which accruals are made for future pensions. The record demonstrates that the pension accruals exceed by some five times the actual cost of the pension system, and that it will be probably seventy-five years before the current cost of pensions equals the annual accruals of pension reserves. Does the due process clause of the Fourteenth Amendment to the United States Constitution require the Public Utilities Commission to consider the entire amount accrued annually for pensions as a current operating cost in fixing rates for Northwestern's intrastate telephone services?

Statement of the Case

Petitioners seek to review a judgment of the Supreme Court of South Dakota, entered on July 10, 1950, which required the Public Utilities Commission to grant an increase of rates for intrastate telephone services for which Northwestern Bell Telephone Company had applied, and which the Public Utilities Commission had denied on the ground that the existing rates provided an adequate and fair return for the company. Petitioners are both civic organizations who were permitted to intervene in the original proceedings before the Commission as representatives of the public interest [Record, p. 50] and have been parties to all of the subsequent proceedings.

On December 27, 1946, Northwestern was granted an increase in rates for its intrastate services [Record, p. 9]. On November 24, 1947, the company applied for fur-

ther increases in its rates [Record, p. 5]. In this application, it alleged that its intrastate plant, including working capital, had a value of $15,446,725; that its annual revenues were $4,862,264 and that its annual expenses were $4,709,514, as a result of which its net telephone earnings were $152,750, a percentage return of .99 [Record, p. 11]. Subsequently, on November 29, 1948, the company amended its application and alleged that it had increased its investment in telephone plant assignable to intrastate operations in South Dakota over $2,357,000, and that the expenses assignable to its intrastate operations had increased approximately $212,000 on an annual basis. [Record, p. 34].

The Commission held full hearings on the company's application, at the close of which it found that the depreciated fair value of all of the company's South Dakota property, including a reasonable working capital, was on the average, for the year 1948, $11,930,306 [Commission's Finding No. 27, Record, p. 84]. The company's annual revenues were found to be $5,427,617 and its total operating expenses were determined to be $4,594,542, and the net income available for return was $833,075 [Record, p. 78].

On the basis of these findings, the Commission concluded that the existing rates were fair, just, and reasonable, and denied the company's application for higher rates [Record, p. 84].

In considering the application for a rate increase, the Commission rejected certain items of current operating expenses claimed by the company and also certain items of plant valuation. The items rejected, and the reason for their rejection, as stated by the Public Utilities Commission, are as follows:

(1) The company asserted that it had allocated the expenses as between intrastate and interstate services

upon the basis of a formula supplied to it by American Telephone and Telegraph Company, the sole owner of Northwestern's stock. The formula of separation was a statistical one developed by American on the basis of cost studies conducted in Illinois, California, Michigan, Wisconsin, Alabama, Louisiana, and North Carolina in 1934 [Commission's Transcript, p. 1633] and in Pennsylvania and Washington in 1938 [Commission's Transcript, p. 1633]. The application of the formula derived from these studies resulted in the assignment of 80.2 per cent of the operating expenses to intrastate services. However, 77.56 per cent of the total revenues were derived from intrastate operations, and 77.77 per cent of plant valuation was assigned to such operations [Record, p. 65]. The Commission found that the company's method of separating intrastate and interstate expenses was unfair to the intrastate services and rejected it [Record, p. 64]. It therefore concluded that the separation should be made on the basis of the proportions set up by the company for the separation of the value of plant and equipment, and allocated the expense by charging 77.77 per cent to the intrastate operations [Record, p. 65].

(2) The company claimed as expense for depreciation $665,469 [Applicant's Exhibit A-94, Commission Transcript, p. 2360]. These annual charges for depreciation are credited to a depreciation reserve account, the only purpose of which is to provide for the actual losses sustained by the company in the retirement of its property [Record, p. 66a]. The Commission found that the annual accruals for depreciation greatly exceed the actual losses from retirement of plant and equipment. The extent of the excess is demonstrated by the fact that at the end of 1947 the depreciation reserve balance stood at $88,423,870, or 39.46 per cent of the entire book cost of Northwestern's depreciable plant [Exhibit P-102, Commission's Transcript,

p. 2348]. On the basis of this evidence, the Commission concluded that the reasonable and proper rate of depreciation was 2.5392 per cent, and that the reasonable and proper amount to be allowed as the annual charge for depreciation for the South Dakota property was $392,567 [Commission's Findings Nos. 22 and 23, Record p. 83].

(3) Northwestern claimed as an expense of operating certain payments which were made under a "License Contract" to American Telephone & Telegraph. Northwestern refused to make any showing as to the services, if any, which it received from American in return for these payments [Commission's Transcript, p. 715 *et seq.*] and the Commission found that there was no evidence in the record from which it could make any finding with reference to services rendered in South Dakota, or that the payments by Northwestern were commensurate with the services rendered by American [Commission's Findings No. 21, Record, p. 83]. American allocated all of its holding company expenses to various operating companies without regard to any segregation of holding company and operating company services [Commission's Transcript, p. 1689]. The Commission therefore deducted these payments from the operating expenses of Northwestern in South Dakota.

(4) The Company claimed as current operating expenses certain reserves accrued for future pension payments to employees, and held in a trust fund for that purpose. The Commission found that the Company was accruing reserves for pensions at a ratio of 516 per cent of the amount actually paid for current pensions. In 1948, Northwestern Bell Telephone accrued a total of $3,632,269 for the pension trust fund, all of which was charged to current operating expenses. However, only $703,281 was actually paid for current pensions in that year [Exhibit A-124, Commission's Transcript, p. 2444]. The Company actuary justified these greatly excessive accruals of pen-

sion reserves on the ground that at some future time the payments for pensions would exceed the amount of the accruals, but admitted that he could not make any intelligent estimate as to the time at which that point would be reached [Commission's Transcript, p. 930], and said that he could not even guess whether the period was an early one—ten to fifteen years from the present, or a remote one—fifty, seventy-five, or a hundred years from the present [Commission's Transcript, p. 931].

On the basis of this evidence, the Commission found that the company had failed to justify the pension accruals as current operating expenses, and allowed as such expenses only the cost of a pay-as-you-go pension plan. This determination reduced the current operating expenses by $172,894 [Record, p. 71].

(5) The Commission found that Northwestern purchased practically all of its equipment from Western Electric Company. American Telephone and Telegraph owns all of the stock of Northwestern and 99 per cent of the stock of Western Electric. The Commission found that the profits of Western Electric were excessive [Record, p. 75], as a result of which excessive profits, it found, the cost of the South Dakota intrastate plant had been increased by $371,475 [Record, p. 79], and that the maintenance and current expense accounts represented excessive operating costs to Northwestern in 1947 of $80,496 and in 1948 of $110,033. In view of the close interrelationship of the three companies, the Commission eliminated the excess earnings of Western Electric from the rate base and from the current operating expenses claimed by Northwestern.

(6) The Commission disallowed as a part of the cost of the South Dakota plant and equipment the sum of $516,000 which had been expended by the Company in metallicizing its rural lines. The Commission eliminated

this cost for the reason that the applicable statute of South Dakota (South Dakota Code, § 21.101) imposes this cost on the electric utility whose lines are affected. The South Dakota Supreme Court interpreted the section as allowing the telephone management, in its discretion, to waive its right of re-imbursement. This determination is solely one of South Dakota law, and petitioners do not ask for a review of this issue. However, the item affects only the rate base, and in view of the relatively small amount involved, the inclusion or exclusion of this cost has an insignificant effect on the issue of whether or not the utility's rate of return is fair and reasonable.

After disallowing the items specified, the Commission determined that the existing rates provided the Company with a fair and reasonable return, and denied the requested increases [Record, p. 84].

The following table summarizes the reductions ordered by the Commission in the rate base as of September 30, 1948:

Book Cost of Plant		$18,054,312
Working Capital		927,992
Less the following:		
Telephone Acquisition Adjustment [2]	$451,389	
Western Electric Company excessive earnings	428,427	
Excessive Pension Accruals	55,483	
Cost of Metallicizing Rural Lines	401,293	
Adjusted Book Cost of Investment		17,645,712
Depreciation Reserve		5,341,579
Net Investment (Fair Value Depreciated)		$12,304,133

[2] It is conceded that this item was properly eliminated from the rate base [Record, p. 220].

The following is a summary of the deductions made by the Commission from operating expenses:

Alleged improper separation of interstate and intrastate expense	$124,543
Pensions and relief	131,125
License Contract payment	50,454
Western Electric profits	85,573
Deferred Maintenance	80,000
Depreciation	272,902
Total	$744,597

Following the denial of its application, Northwestern instituted its suit in the Circuit Court of Charles Mix County, South Dakota, on October 24, 1949 [Record, p. 133], alleging that the existing rates approved by the Commission would result in heavy losses to the company, would be confiscatory, and constitute a taking of Northwestern's property without due process of law, contrary to the statutes of South Dakota, and to Section 2 of Article VI of the Constitution of South Dakota, and to Section 1 of the Fourteenth Amendment to the Constitution of the United States [Record, p. 136]. The Supreme Court of South Dakota has held that the State Constitution, Article VI, Sections 2 and 13, and the Fourteenth Amendment to the United States Constitution are identical in meaning. *Application of Northwestern Bell Telephone Company,* 69 S. D. 36, 6 N.W. 2d 165. The Circuit Court found that the Fourteenth Amendment required the Commission to accept all of the challenged items and ordered that the Commission fix rates which would provide a fair return to the company when all of the challenged items were taken as proper expenses [Record, p. 260].

Following this decision, the Commission and the protestants, who are petitioners here, appealed to the Supreme

Court of South Dakota, which affirmed the judgment of the Circuit Court on July 10, 1950 [Record, p. 354], holding that due process required the inclusion of all of the disputed items of expense.

In order to justify the granting of increased rates to Northwestern for its intrastate operations in South Dakota, all of the disputed items must be allowed. If the Commission is sustained as to its reduction of depreciation and any one of the other challenged items, the existing rates give the company a fair return on its investment.

Specification of Errors to Be Urged

The Court erred:

1. In holding that the due process clause of the Fourteenth Amendment to the Constitution of the United States requires the Public Utilities Commission to accept and act upon the company's formula for the separation of intrastate and interstate business.

2. In holding that the due process clause of the Fourteenth Amendment to the Constitution of the United States requires the Public Utilities Commission to accept the company's accruals of reserves for depreciation as current operating costs despite the fact that such accruals are greatly in excess of the actual retirement experience of the company.

3. In holding that the Public Utilities Commission may not, under the due process clause, reduce the amounts accrued as reserves for employees' pensions on the basis of evidence showing that the actual cost of the company's pension system will not equal the amounts accrued as reserves for a period of approximately seventy-five years.

4. In holding that the due process clause requires the Public Utilities Commission to accept as current operating

expenses all of the amounts paid by Northwestern Bell Telephone Company to the American Telephone and Telegraph Company under the License Contract Agreement, even though the record is silent as to the nature and amount of services, if any, rendered by American Telephone and Telegraph Company to the intrastate telephone operations of Northwestern Bell Telephone Company.

5. In holding that the due process clause of the Fourteenth Amendment prohibits the Public Utilities Commission from investigating the profits of Western Electric Company, another wholly controlled subsidiary of American Telephone and Telegraph, and, to the extent that the profits on equipment sold to Northwestern are excessive, reducing the plant cost and operating expenses of Northwestern for rate making purposes.

Reasons for Granting the Writ

In requiring the Public Utilities Commission to accept the company's calculation of its rate base and its operating expenses, the Supreme Court of South Dakota entered the judgment in this case because it felt constrained by the Fourteenth Amendment to the United States Constitution so to do. As we have pointed out, the sole attack made by the utility on the rate order was based upon the assertion that the rates enforced were confiscatory and deprived the company of its property without due process of law. The Supreme Court of South Dakota held that the due process clause of the Fourteenth Amendment was identical in meaning to the due process clause of the South Dakota Constitution [Record, pp. 358-359a]. As a result, the questions of interpretation are so interwoven with the interpretation of the Fourteenth Amendment that it is clear that the Court felt that the requirements of the latter were controlling in its determination. Under such circumstances,

if the Supreme Court of South Dakota felt—as it did—that it was compelled by the Federal Constitution to reach its decision, the judgment is one which this Court should review. *Coleman* v. *Miller*, 307 U. S. 433, 437; *State Tax Commission* v. *Van Cott*, 306 U. S. 511, 514; *Abie State Bank* v. *Bryan*, 282 U. S. 765, 773. As we shall show in the following paragraphs, the construction which the South Dakota Supreme Court placed upon the due process clause in this case was contrary to the applicable decisions of this Court, notably *Smith* v. *Illinois Bell Telephone Company*, 282 U. S. 133, and *Lindheimer* v. *Illinois Bell Telephone Company*, 292 U. S. 151.

(a) *The Public Utilities Commission was not required by the due process clause to accept the company's separations procedures, which were not based upon South Dakota experience, and which in the commission's judgment placed an unfair burden upon the users of intrastate telephone services in South Dakota.*

The proper separation of revenues, expenses, and investment is essential for the proper and effective determination of utilities rates, because without such separation it is impossible to define the governmental responsibilities involved. *Smith* v. *Illinois Bell Telephone Co., supra.* Proper separation procedures would result from a cost study of the respective costs of intrastate service as compared with the costs of interstate service. *Smith* v. *Illinois Bell Telephone Co., supra.* Such a method of separation was not adopted by Northwestern Bell Telephone Company in support of its application for increased rates. Instead a staff of technicians of American Telephone and Telegraph Company conducted cost studies in Illinois, California, Michigan, Wisconsin, Alabama, Louisiana, and

North Carolina in 1934, and in Pennsylvania and Washington in 1938 [Commission's Transcript, p. 1633]. From these cost studies, they developed a separations formula which Northwestern claimed to have adopted in the calculation of its revenues and expenses. However, the company's witnesses admitted that they had applied the formula only to the factor of plant use.

The commission found that the separations formula adopted by the company was unfair to the intrastate operations and placed an undue burden on the users of local service. Its conclusion was based upon cogent reasons: that the formula failed to take into account the indispensable nature of the local service plant, without which the interstate operations would be impossible and for which the American Telephone and Telegraph system credited nothing to Northwestern's South Dakota operation; it failed to consider the greater economic value of the long distance calls; and it failed to consider the factors of the division of revenues and the division of plant values, both of which were shown specifically as to the South Dakota operations. [Record, pp. 64, 65]. Still another cogent objection to the use of the separation formula adopted by the company is in the fact that there are basic geographical and climatic considerations which differentiate South Dakota from the states in which the cost studies were conducted.

The Company's separations formula imposed 80.2 per cent of the operating expenses upon South Dakota users. The commission found that the factors of revenues and plant valuation were practically identical, and having before it no other evidence upon which a separation could be based, took the plant valuation—the factor more favorable to the Company—as the basis of the separation. In so doing, it exercised its best judgment on a question which

involves judgment on a myriad of facts. Cf. *Colorado Interstate Gas Co.* v. *Federal Power Commission*, 324 U. S. 581. The burden was clearly upon the company to establish that the rates were confiscatory of its property, and in order to accomplish this, it was required to show with accuracy the separation between its intrastate and interstate business. *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133. Since the formula adopted by the company was obviously unfair to the intrastate users, it is clear that the due process clause does not require the South Dakota Commission to accept it. The formula adopted by the commission is a reasonable exercise of its judgment, and the Court was in error in overruling its administrative determination.

(b) *The Fourteenth Amendment does not require the Public Utilities Commission to allow the excessive depreciation reserves accrued by the Company as current expenses.*

The Public Utilities Commission attempted to challenge Northwestern's accumulation of tremendous reserves for depreciation. The Supreme Court of South Dakota, in this decision, held that the due process clause prevented such a challenge because the Company showed that its accounting methods were in strict accordance with those prescribed by the Federal Communications Commission.

In reaching this decision, the South Dakota Court ignored the essential facts. The company's burden of proof that its depreciation rates are not excessive is not met by showing that its accounting methods are correct. *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U. S. 151, 167. This is so because while the calculation of depreciation is basically a matter of judgment and opinion as to the service life of plant and equipment, this preliminary judgment

cannot be the final test if experience fails to bear it out. Depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. The amount properly allowed in the calculation of rates is that necessary to maintain the integrity of investment. *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U. S. 151, 167.

The effect of the Commission's opinion was to hold that the company's method of accruing depreciation was one by which subscribers for telephone service over a period of years are required to provide capital contributions, not to make good losses made by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which it may gain a return. *Lindheimer* v. *Illinois Bell Telephone Co.*, *supra*. And see, dissenting opinion of Mr. Justice Sickel, Record, p. 379.

The Commission's findings were based on a complete study made by its engineering staff of Northwestern Bell retirement experience and salvage experience for the past fifteen years. Upon this study and analysis the Commission's chief engineer testified as to the proper rates of depreciation, both as to classes of plant and as a composite annual rate [Exhibit P-90, and Supplement; Commission's Transcript, pp. 2341, 2433]. Upon this analytical study the Commission made its finding that an adequate accrual of depreciation for the year 1948 was $392,567 [Finding No. 23, Record, p. 83].

The company's own evidence in this case shows that, however correct its accounting methods, the results of its depreciation methods are that grossly excessive funds have been accumulated in its depreciation reserves [Exhibit A-135, Commission's Transcript, p. 2649]. The reserves for this purpose on December 31, 1947, represented 39.46 per

cent of the entire value of Northwestern's plant [Record, p. 66a].

The South Dakota Court held that the excess accumulation of depreciation reserves was not evidence upon which the Commission could base its finding that the depreciation reserves were higher than could properly be charged to current expenses. This holding is in direct conflict with that of this Court in *Lindheimer* v. *Illinois Bell Telephone Co.,* 292 U. S. 151, which approved an order of the Illinois Commerce Commission based on precisely the same type of evidence rejecting the telephone company's depreciation rates.

Unless a regulatory commission has authority to challenge the depreciation methods on the ground that the ultimate result of such methods is not sound, then the regulation of utilities becomes a practical impossibility. Excessive rates can be obtained by the inclusion of exaggerated items of expense, and commissions can perform their lawful functions only by examining and challenging such unjustifiable items. The Bell system has used the depreciation reserves as a method of consistently increasing its operating expenses, and receiving contributions by users to its capital funds. The Company's methods have been the subject of bitter dispute in telephone rate making for many years. "Report of the Federal Communications Commission of the Investigation of the Telephone Industry in the United States," *House Document No. 340,* 76th Cong., 1st Sess., p. 325.

Depreciation methods are a vital factor in rate making. To the extent that the annual charges for depreciation include amounts not required for the purpose of maintaining the integrity of the plant, the depreciation account misrepresents the cost of service. In the instant case, the misrepresentation of $272,902 in depreciation represents a

six per cent return on $4,548,000 or more than one-third of the total value of the South Dakota plant. The South Dakota Court's decision means that the users of telephone service in South Dakota must pay the company a return on a plant, more than one-fourth of which does not exist. To say that this result is compelled by the Fourteenth Amendment is, we respectfully submit, a conception patently at variance with the applicable decisions of this Court.

(c) *The Due Process Clause does not require the Commission to allow as current expenses the excessive accruals of pension.*

The third respect in which it was held by the State Court below that the Constitution is violated has to do with the pension system of Northwestern Bell Telephone Company. In this matter the Commission was confronted with two alternative systems, equally advantageous and generous to employees, one of which is economical, and the other of which is so extravagant as to create the presumption that undisclosed and dubious motives of the parent corporation dictated its use by the company. The Commission prescribed that method of accrual calculated to impose the least burden upon subscribers for at least the next seventy-five years, according to the Company's admission.

The Supreme Court of South Dakota mistakenly held, however, that this regulation of pension accruals violated Constitutional limitations, and to the extent of the adjustment ordered by the Commission, confiscated the telephone company's property without due process of law.

The question presented as to whether the allowance of pension accruals on the basis adjudicated by the Commission is constitutionally inadequate is one not heretofore determined by this Court.

(d) *The Fourteenth Amendment does not require the Commission to accept, for rate making purposes, the "license contract" payments to the American Telephone and Telegraph Company.*

Northwestern claimed as an operating expense payments by it to American Telephone and Telegraph Company, the owner of all of the stock of Northwestern. For the South Dakota operations, the payment amounted to about $54,000 for the year 1948. Before the Commission, the Company took the position that the amount, character, and cost of the services actually rendered was immaterial, since the activities of the holding company may have resulted in benefit to the South Dakota intrastate operations [Commission's Transcript, pp. 716-729]. The company was unable to make any estimate of any actual services performed for or in South Dakota. The total expense of American Telephone and Telegraph (excepting only Long Lines operations), was allocated to the various operating companies [Commission's Transcript, p. 725]. For example, the costs allocated include the printing of stock certificates, the cost of dividend checks, and the cost of mailings to stockholders of American Telephone and Telegraph Company [Commission's Transcript, p. 771]. They also include the salaries of all officers of American Telephone and Telegraph [Commission's Transcript, p. 772].

With this evidence before it, the Commission held that the Company had failed to prove the value and cost of the services rendered by American to Northwestern, if there were any such services at all.

The South Dakota Court held that the Fourteenth Amendment required the Public Utilities Commission to accept the accountant's allocation of all of the costs of American and to include them in the calculation of rates. This decision is directly in conflict with the holdings of

this Court, which have uniformly sustained the view that the Commission may inquire into the reasonableness and type of services supplied by the parent company, and may consider the cost to the holding company of the services actually supplied by it. *Smith* v. *Illinois Bell Telephone Company,* 282 U.S. 133, 161; *Western Distributing Co.* v. *Public Service Commission of Kansas,* 285 U.S. 119, 124; *Dayton Power and Light Co.* v. *Public Utilities Commission,* 292 U.S. 290, 295, 298, 307-308; *Columbus Gas & Fuel Co.* v. *Public Utilities Commission,* 292 U.S. 398, 400, 401.

(e) *Since Northwestern failed to sustain the burden of proving that the payments for equipment to Western Electric were proper, the Commission had a right, under the Due Process Clause, to eliminate the excessive profits of that company from Northwestern's rate base and operating expenses.*

One of the basic items of the calculation of telephone rates is the cost of telephone equipment which enters into the rate calculation in the determination of the rate base upon which the return is calculated and into the determination of the expense for expendable equipment.

The Public Utilities Commission attempted to go behind the actual payments made by Northwestern to Western Electric Company. On the basis of the earnings of Western Electric Company, the Commission concluded that the charges made to Northwestern were excessive and eliminated the excess profits from the calculation of rates.

A determination of the charges made by Western Electric to Northwestern must be made in the light of the fact that American Telephone and Telegraph owns all of the stock of Northwestern and 99 per cent of the stock of Western Electric [Commission's Transcript, p. 702]. The payments between the two companies, are, therefore, ex-

changes of funds and credits between wholly controlled subsidiaries of the same parent. Unless the Commission has power to investigate that relationship, it is faced with the fact that Western Electric's charges are not subject to control, and yet this uncontrolled cost is a substantial factor in the calculation of Northwestern's rates. In this case, Northwestern attempted to defend the reasonableness of Western Electric's charges by showing that the prices of that company were comparable to those charged by independents, and the South Dakota Court held that the due process clause compelled the acceptance of that comparison. Such a comparison is factually unsound because it ignores the factors of size of market, advance information as to the needs of Western's customers, the absence of sales cost to Western, and the relative credit risks incurred by independents. "Report of the Federal Communications Commission of the Investigation of the Telephone Industry in the United States," *House Document No. 360,* 76th Cong., 1st Sess., p. 323.

In this case, the undisputed proof, and indeed the testimony of the telephone company itself, is to the effect that for many years the earnings of Western Electric Company have been so abnormally great that the embarrassingly large profits have been placed in various newly created surplus reserves and charged as "non-current expenses." The annual reports of Western Electric Company for the past ten years show the extent of these reserve accretions, without which charges against operating revenues the rates of return would have been more than 30 per cent of the paid-in capital of this particular—and non-regulated—Bell system subsidiary [Commission's Transcript, pp. 1707-1727; Exhibits A-125 to A-134, inclusive, pp. 2445-2648; P-109 (revised) to P-113 (revised), pp. 2650-2656]. It was these enormous profits which the Commission con-

cluded should not be charged against the users of telephone service in South Dakota. The South Dakota Court held that the Fourteenth Amendment requires them to be imposed upon the public.

There can be no doubt, from the decisions of this Court, that the determinations of the Public Utilities Commission should be sustained unless they are so unreasonable that no fair-minded board could have reached such a conclusion. *Knoxville* v. *Knoxville Water Co.,* 212 U.S. 1, 16; cf. *St. Joseph Stockyards Co.* v. *United States,* 298 U.S. 38. Nor can the right of the Commission to investigate the interrelations of the holding company system be challenged. *Western Distributing Co.* v. *Public Service Commission of Kansas,* 285 U.S. 119, 124.

The decision of the South Dakota Court is, therefore, a substantial interference with the authority of regulatory bodies, acting in the public interest, to control rates and to maintain rates which are fair to the consumer. The Commission's duty to be fair to the users of telephone service is an obligation as great as its duty to fix rates which are fair to Northwestern. The South Dakota Court, in preventing effective regulation of a basic cost of telephone service, has prevented the Commission from fulfilling that duty to the public. Its decision, which it purported to rest upon the Fourteenth Amendment, is contrary to the decisions of this Court.

Conclusion

For the foregoing reasons, it is respectfully submitted that a Writ of Certiorari should be granted, and the judgment of the Supreme Court of South Dakota reversed.

CARL W. BERUEFFY,
JOSEPH ROBBIE, JR.,
Attorneys for Petitioners.

Office-Supreme Court, U. S.
FILED
JAN 11 1951
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950.

No. 407

FARMERS' UNION EDUCATIONAL AND COOPERATIVE ASSOCIATION OF SOUTH DAKOTA AND JUNIOR CHAMBER OF COMMERCE OF MITCHELL,

Petitioners,

vs.

NORTHWESTERN BELL TELEPHONE COMPANY,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF SOUTH DAKOTA.

HARRIS A. POLEY,
DOUGLAS F. SMITH,
RICHARD L. SELLE,
Attorneys for Respondent.

T. J. PEYCKE,
SIDLEY, AUSTIN, BURGESS & SMITH,
Of Counsel.

THE GUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

INDEX.

	PAGE
Opinions below	1
Jurisdiction	2
Statement of the Case	4
Questions Presented	7
Argument	8
I. The petitioners lack standing to seek certiorari because of their failure to assign or to brief error in the South Dakota Supreme Court	8
II. The judgment of the Supreme Court of South Dakota did not depend upon the determination of a federal question	11
III. No substantial question is presented by the petition because the determinations of the courts below not properly assigned as error have established that the Commission's order would restrict the Company to a return of less than 3% on its net investment	15
IV. The determinations of the State Court which are specified as error by the petitioners are not in probable conflict with applicable decisions of this Court	18
Separation of expenses	18
Depreciation expense	21
Pension expense	23
License contract expense	25
Western Electric profits	27
Conclusion	29

CITATIONS.

Cases.

Abie State Bank v. Bryan, 282 U. S. 765 13
Bailey v. Anderson, 326 U. S. 203 17
Banton v. Belt Line Ry., 268 U. S. 413 25
Central Savings Bank v. City of New York, 280 N. Y. 9, 19 N. E. (2d) 659 14
Chambers v. Wilson, 67 S. D. 495, 294 N. W. 180 9
Coleman v. Miller, 307 U. S. 433 13
Colorado Interstate Gas Co. v. Federal Power Comm'n, 324 U. S. 581 20
Consolidated Turnpike Co. v. Norfolk & Ocean View Ry. Co., 228 U. S. 596 17
Dakota Transportation, Inc. of Sioux Falls, Application of, 67 S. D. 221, 291 N. W. 589 ..... 6, 20
Fox Film Corp. v. Muller, 296 U. S. 207 11
General Talking Pictures Corp. v. Western Electric Co., 304 U. S. 175 16
Grayson v. Harris, 267 U. S. 352 12
Herb v. Pitcairn, 324 U. S. 117 ..... 11, 13
Honeyman v. Hanan, 300 U. S. 14 ..... 13, 17
Johnson v. Risk, 137 U. S. 300 12
Klinger v. Missouri, 13 Wall. 257 11
Levy v. Superior Court of San Francisco, 167 U. S. 175 14
Lindheimer v. Illinois Bell Telephone Co., 292 U. S. 151 ..... 21, 22, 23
Lynch v. New York ex rel. Pierson, 293 U. S. 52 ..... 11, 12
McGoldrick v. Gulf Oil Corp., 309 U. S. 2 13
Minnesota v. National Tea Co., 309 U. S. 551 ..... 13, 14

Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Comm'n, 262 U. S. 276 25

Murdock v. Memphis, 20 Wall. 590 11

National Licorice Co. v. National Labor Relations Board, 309 U. S. 350 16

National Tea Co. v. State, 205 Minn. 443, 286 N. W. 360 14

New York City v. Central Savings Bank, 306 U. S. 661 ..... 13, 14

Northwestern Bell Telephone Co., Application of, 69 S. D. 36, 6 N. W. (2d) 165 ..... 3, 14, 16, 20

Northwestern Bell Telephone Co., In re, 43 N. W. (2d) 553 (S. D.) 1

Public Service Comm'n v. Wisconsin Telephone Co., 309 U. S. 657 13

Puget Sound Power & Light Co. v. Kings County, 264 U. S. 22 10

Radio Station WOW, Inc. v. Johnson, 326 U. S. 120 ... 11

Seubert v. Fawick Tractor Co., 36 S. D. 213, 154 N. W. 446 9

Smith v. Illinois Bell Telephone Co., 282 U. S. 133 . 25, 26, 27

Southwestern Bell Telephone Co. v. Oklahoma, 303 U. S. 206 11

St. Josephs Stock Yards Co. v. United States, 298 U. S. 38 14

State Tax Comm'n of Utah v. Van Cott, 306 U. S. 511. 13

Sully v. American National Bank, 178 U. S. 289 10

Virginia v. Imperial Coal Sales Co., Inc., 293 U. S. 15 .. 12

West Ohio Gas Co. v. Public Utilities Comm'n of Ohio (No. 1), 294 U. S. 63 ..... 16, 25

Williams v. Kaiser, 323 U. S. 474 11

Williams Bros. Lumber Co. v. Kelly, 23 S. D. 582, 122 N. W. 646..... 9

Wilson v. Cook, 327 U. S. 474..... 16

Statutes.

Section 1257(3), Title 28, United States Code (Act of June 25, 1948, c. 646, § 1257 (3), 62 Stat. 929)..... 11

Sections 33.0735 and 33.0743, Title 33, Judicial Procedure, Civil, South Dakota Code of 1939..... 8

DARK PAGE BLEED THRU

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950.

No. 407.

FARMERS' UNION EDUCATIONAL AND COOPERATIVE ASSOCIATION OF SOUTH DAKOTA AND JUNIOR CHAMBER OF COMMERCE OF MITCHELL,

Petitioners,

vs.

NORTHWESTERN BELL TELEPHONE COMPANY,

Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF SOUTH DAKOTA.

OPINIONS BELOW.

The opinion of the Supreme Court of South Dakota rendered July 10, 1950, is not yet officially reported in the South Dakota State Reports; it is unofficially reported, 43 N. W. (2d) 553. The opinion is in the record at pages 354 to 381, inclusive. The case was appealed to the Supreme Court of South Dakota from the Circuit Court of Charles Mix County, South Dakota; the opinion of that court is in the record at pages 202 to 260. The findings, opinion

and order of the Public Utilities Commission of South Dakota, not officially reported, appear in the record at pages 54 to 111 and in 81 P. U. R. (N. S.) 375.[1]

JURISDICTION.

Jurisdiction of this Court is denied on the ground that the decision below did not depend upon the determination of a federal question. This will be discussed in the argument, but attention is directed here to certain statements in the petition which are misleading.

Making the assumption that the decision below rests on the determination of a federal question, the petitioners state in respect to each of five matters, under the caption, "Questions Presented," as follows:

> "Does the due process clause of the Fourteenth Amendment to the Constitution of the United States *require* the South Dakota Public Utilities Commission [to take certain designated action] . . .?" (Pet. pp. 2-4.)

As the basis for this assumption, petitioners, in their "Specification of Errors," aver in substance as to each of the same five points that the court erred in holding that the due process clause of the Fourteenth Amendment to the Constitution of the United States "*requires*" the Public Utilities Commission to take the action to which refer-

[1] Citations to the formal papers in the record, numbered pages 1 to 599, appear as follows: (R. .....); references to the transcript of testimony and exhibits before the Public Utilities Commission, as follows: (Com. Tr. p. .....) (Ex. ....., Com. Tr. p. .....); references to the Petition, as follows: (Pet. p. .....).

Throughout this brief the Public Utilities Commission of South Dakota will be referred to as Commission; the Supreme Court of South Dakota, as State Court; the Circuit Court of Charles Mix County, as trial court; the respondent Northwestern Bell Telephone Company, as Company; the American Telephone & Telegraph Company, as American Company.

Throughout this brief italics are added by respondent.

ence is made. (Pet. pp. 11-12.) Finally, after numerous other statements of like character, petitioners conclude their statement of "Reasons for Granting the Writ" by asserting:

> "Its decision, *which it purported to rest on the Fourteenth Amendment,* is contrary to the decisions of this Court." (Pet. p. 22.)

These repeated statements represent to this Court that the Supreme Court of South Dakota declared that it was required or constrained to hold as it did by the Fourteenth Amendment. The opinion contains no such statement. On the contrary, it contains only a single reference to the federal Constitution, and that is made indirectly, in discussing the scope of review of administrative orders, by a quotation from one of the State Court's opinions in an earlier case *in which no federal constitutional question was involved.*[2] (R. 358-59.)

---

[2] This quotation, which is from the opinion of the Supreme Court of South Dakota in *Application of Northwestern Bell Telephone Co.*, 69 S. D. 36, 6 N. W. (2d) 165, is, in part, as follows:

> "'The State Constitution (Art. VI, §§ 2 and 13) and the United States Constitution (Amendments V and XIV) provide alike that no person shall be deprived of life, liberty or property without due process of law, and that private property shall not be taken without just compensation.'"

This language was, in that opinion, immediately preceded by the statement:

> "The case just cited [*Application of Dakota Transportation, Inc., of Sioux Falls,* 67 S. D. 221, 291 N. W. 589] *refers with approval* to the decision of the United States Court in *St. Joseph Stockyards Co.* v. *United States* . . ." 69 S. D. at 45, 6 N. W. (2d) at 170.

In the quoted opinion the court was concerned only with an asserted "violation of statute and the due process clause of the State Constitution." 69 S. D. at 41, 6 N. W. (2d) at 168. It called attention to the identity of the due process provisions of the State and federal Constitutions simply as an explanation of the citation of federal decisions which it deemed persuasive as to the meaning of the State Constitution.

STATEMENT OF THE CASE.

Petitioners' statement of the grounds of the adjustments made by the Commission contains numerous inaccuracies and omissions. Many of these are pointed out and discussed in the Argument which follows, and to avoid repetition they are not covered here.

In November, 1947, the Company filed its application with the Public Utilities Commission of South Dakota asking an increase in the rates for telephone service rendered in that State. (R. 5.) In November, 1948, the Company filed a supplement and amendment thereto, seeking additional relief. (R. 34.) At the hearings before the Commission, the Company showed that, following the granting of a substantial wage increase to its employees in the latter part of October, 1948, its South Dakota intrastate operations were resulting in a net loss equal to $216,239 on an annual basis.[3] (Ex. A-93, Com. Tr.

[3] This very substantial deficit followed a long period in which the Company had suffered grossly inadequate earnings, as the trial court found.

The trial court said: "The Commission at the time it made its order of December 27, 1946, was aware and had officially found as a fact that appellant had been operating under inadequate and confiscatory rates from 1942 to 1945, inclusive." (R. 212.) "* * * on December 27, 1946, the Commission after negotiation with appellant [the Company] granted an increase in rates which was estimated to result in net earnings of 3.21% upon the book cost less depreciation plus working capital, but would have, in fact, resulted in net earnings of 3.06%, and that the net earnings of appellant for 1947 were less than 1½% and that in 1948 appellant operated at a net loss; * * *." (R. 252-253.)

"What constitutes a fair rate of return was discussed in *Application of Northwestern Bell Telephone Co.*, 69 S. D. 36, 6 N. W. 2d 165. The Commission knew this when it made its order now in effect fixing a rate estimated to be a little over three per cent when a fair rate would have been about six per cent.

"The following language quoted in the South Dakota case last above mentioned from *St. Joseph Stock Yards Co.* v. *United States*, may be rather mild:

> "'Legislative agencies, with varying qualifications, work in a field peculiarly exposed to political demands. Some may be impartial, others subservient.'" (R. 249.)

pp. 2357, 2358.) On October 8, 1949, the Commission denied the application and the amendment thereto *in toto*. (R. 85.)

The basis for this action was an adjustment of the Company's expenses, revenues and investment in reliance on which the Commission found that for the year 1948 the Company was not operating at a deficit as shown by its records and accounts but was earning an annual net income of $833,075. (R. 78, 84.) This was greater by $1,049,314 ($216,239 plus $833,075) than the amount reported by the Company.[4]

Having thus arrived at an asserted net income of $833,075[5] in place of the Company's reported deficit of $216,239, the Commission, purporting to adopt net investment[6] as the rate base, also restated that figure as

[4] The adjustments of expenses and revenues made by the Commission are as follows:

Excess of income, as restated by the Commission, over that reported by the Company		$1,049,314
Reductions in operating expenses on account of:		
1. Separation of interstate and intrastate expense	124,543	
2. Depreciation	272,902	
3. Pensions and relief	131,125	
4. License contract payment	50,454	
5. Purchases from Western Electric	85,573	
6. Deferred Maintenance	80,000	
Total, 6 adjustments of expense	$ 744,597	
Increase in revenue	$ 92,949	
Wage increase in 1948 reflected in Company's figures but overlooked by Commission (Ex. A-93, Com. Tr. p. 2357; R. 230-31, 253.)	$ 211,768	
Total, all above items	$1,049,314	$1,049,314

[5] The trial court found: "The Commission's finding that appellant's intrastate operations for the first nine months annualized resulted in a net income of $833,075 is erroneous and unsupported by any substantial evidence." (R. 259.)

[6] I.e., book cost of plant less depreciation reserve plus working capital. (R. 59.)

reported by the Company for September 30, 1948. By the four adjustments set forth on page 9 of the petition the Commission reduced the Company's book cost of plant plus working capital less depreciation reserve, as shown on its books, from $13,640,725 to $12,304,133, as of September 30, 1948. (R. 60, 80.) Then, computing a so-called average net investment figure and applying thereto its derived net income of $833,075 (R. 80.), while overlooking the fact pointed out by the trial court that very substantial income taxes would have been payable on such an amount of income if actually received (R. 230, 253.), the Commission found that under existing rates the Company was already earning a return of approximately 6%, which it held to be just and reasonable. (R. 84.)

The Company appealed to the Circuit Court of Charles Mix County pursuant to the applicable state statutes. (R. 123.) That Court reversed the Commission's order on the ground that certain of its adjustments of the Company's expenses, revenues and investments were *without support in the evidence,* and that the Commission had disregarded without mention the substantial wage increase in 1948, and the effect of federal income taxes. (R. 252-61.)[7] It held that the rates which the Commission required the Company to maintain for intrastate service were confiscatory, depriving the Company of its property without due process of law in violation of the Constitution of the United States and the Constitution and statutes of South Dakota. (R. 260.)

The Commission appealed, with requisite assignments of error, to the Supreme Court of South Dakota. (R. 263, 264.)

[7] These determinations constituted an adequate basis for setting aside the Commission's order under the State statute. The State Court has repeatedly held that a Commission order based upon findings which are arbitrary and not supported by substantial evidence in the record, will be set aside on a statutory review. *Application of Dakota Transportation, Inc., of Sioux Falls,* 67 S. D. 221, 291 N. W. 589.

Petitioners, who had intervened in the proceedings before the Commission (R. 50, 55) and were made parties in the trial court, filed notice of appeal from the judgment of the trial court (R. 278-79.) but filed no assignment of errors or brief in the State Court, as required by the law of South Dakota, even though the State Court fixed a time in which to do so. (R. 275.) The State Court affirmed the judgment of the trial court. (R. 374.) The Commission did not petition for a writ of certiorari.

The Commission did not assign as error in the State Court the trial court's reversal of some of its findings. (R. 265-268.) Moreover, the petitioners do not challenge here some of the determinations by the State Court.

QUESTIONS PRESENTED.

I. Having filed neither assignments of error nor a brief in the State Court, and thus having raised no issue in that court, do petitioners have any standing to seek certiorari in this Court?

II. Will this Court review a decision of a State Court when it does not appear from the record that the decision of the State Court depended upon a determination by it of a federal question?

III. Certain findings of the trial court were not assigned as error by the Commission and some of the determinations of the State Court are not specified as error by the petitioners here. These unchallenged findings and determinations are sufficient in themselves to establish a return for the Company of less than 3%, a return even lower than the rate of interest on its bonds. Under these circumstances, is a substantial federal question presented by the petition?

IV. Did the State Court make any determination, specified as error here, which is probably in conflict with federal law?

ARGUMENT.

I.

THE PETITIONERS LACK STANDING TO SEEK CERTIORARI BECAUSE OF THEIR FAILURE TO ASSIGN OR TO BRIEF ERROR IN THE SOUTH DAKOTA SUPREME COURT.

The statutes of South Dakota provide that upon appeal to the Supreme Court the appellant must file assignments of error and also a brief containing the assignments upon which the party relies, separately stated and numbered, and a citation of the pages in the record upon which the assignment is based and upon which the party relies to sustain the claim of error. S. D. Code of 1939, Title 33, Judicial Procedure, Civil, sections 33.0735 and 33.0743.[8]

The petitioners as appellants before the State Court applied for time within which to file their assignments of error and brief. (R. 272-74.) Pursuant thereto that Court issued its order fixing the time (R. 275), but petitioners failed to file any assignments of error or brief, and the only assignments before the State Court were those of the Commission. (R. 265-68.)

The State Court has consistently refused to consider any issue not raised by an assignment of error. It has held:

---

[8] The governing statute provides:

> "There shall be attached to the transcript, or served separately within ten days after the appeal is taken if no transcript is used, assignments of the error claimed to exist and on which the appellant relies * * *" (Sec. 33.0735.)

It requires also that the appellant before the Supreme Court must file a brief which shall contain:

> "(4) Assignments of error on which the party relies, separately stated and numbered with the same numbers they bore in the settled record and followed by a citation of the pages and lines of such pages in the settled record upon which the assignment is based and upon which the party relies to sustain the claim of error; * * *" (Section 33.0743.)

"The failure to file any assignment of errors must consequently entail an affirmance of the judgment or decree and dismissal of the appeal." *Seubert* v. *Fawick Tractor Co.*, 36 S. D. 213, 154 N. W. 446, 447. It has also held that even when assignments of error have been properly made, the failure to brief such assignments constitutes an abandonment of the points. *Chambers* v. *Wilson*, 67 S. D. 495, 294 N. W. 180.

The State Court disposed of the Commission's assignments in its opinion and affirmed the judgment of the trial court both in the Commission's appeal and in the petitioners' nominal appeal. Nothing in the opinion or elsewhere in the record is inconsistent with the conclusion that affirmance in petitioners' appeal was based on their failure to raise or brief any question in the State Court. That Court has categorically stated that it is its duty so to dispose of an appeal in which assignments of error were not made.

> "This rule of the court is mandatory, and must be complied with, and, unless complied with, the judgment of the court below must be affirmed. * * * *in the absence of an assignment of errors* this court is not required to review the proceedings of the court below, and that *it is our duty in such case to affirm the judgment of the circuit court.*" *Williams Bros. Lumber Co.* v. *Kelly*, 23 S. D. 582, 583, 584, 122 N. W. 646, 646-47.

The result is that the sole petitioners in this Court had no standing in the court whose decision they seek to have reviewed. And it is equally plain that this was an adequate state ground for the affirmance in their appeal by the State Court.

Moreover, under the decisions of this Court, petitioners' failure to raise any question in the State court deprives them of the right to obtain review in this Court. They may not appear here for the first time to raise questions which they left to others, not now here, to raise in

the Court below. This Court has held that to be entitled to be heard here petitioners must themselves have raised in the Court below the questions on which they desire to be heard.

In *Sully* v. *American National Bank,* 178 U. S. 289, the court said at page 297:

> "However it may be in regard to the rights of parties on appeal in the state court, we think that in order to be heard in this court the question must have been raised in the state court by the individual who seeks to have it reviewed here. A plaintiff in error in this court must show that he has himself raised the question in the state court which he argues here, and it will not aid him to show that some one else has raised it in the state court, while he failed himself to do so."

In *Puget Sound Power & Light Co., et al.* v. *Kings County,* 264 U. S. 22, the City of Seattle and a street railway company took separate appeals to this Court. A motion to dismiss as to the City was granted, the court saying at page 25:

> "No evidence appears in the record that it raised an objection based on the Fourteenth Amendment to the Federal Constitution or any federal question in the Superior Court or Supreme Court. It is too late for the City to raise it in the assignment of errors in this Court, even though it joins in the assignment with the Street Railway Company, which did raise such an objection in all the courts."[9]

The soundness of this rule is obvious. Petitioners have not subjected the arguments which they advance here to the criticism of the court of whose decision they seek a review. The Commission, which bore responsibility for the presentation of the case below, has not sought review in this Court.

[9] In that case, as in this, both parties had appealed to the highest court of the state and a single judgment of affirmance had been entered in all appeals. Here petitioners did not even join in the Commission's assignments of error in the court below.

The petitioners appear here, so far as the record shows, as intervenors in the proceedings below for the sole purpose of appeal to this Court. It is respectfully submitted that on this ground alone the writ should be denied.

II.

THE JUDGMENT OF THE SUPREME COURT OF SOUTH DAKOTA DID NOT DEPEND UPON THE DETERMINATION OF A FEDERAL QUESTION.

Petitioners invoke the jurisdiction of this Court under Section 1257(3) of Title 28, United States Code (Act of June 25, 1948 c. 646, § 1257(3), 62 Stat. 929). Since the jurisdiction to review State judgments which arises under that section is a jurisdiction only to correct them insofar as they adjudge federal rights, its exercise is effective only if a federal question was raised o decided and the determination thereof was essential to the disposition of the cause. *Murdock* v. *Memphis,* 20 Wall. 590; *Herb* v. *Pitcairn,* 324 U. S. 117, 125-26. A judgment supported by an adequate State ground will therefore not be reviewed. *Klinger* v. *Missouri,* 13 Wall. 257; *Fox Film Corp.* v. *Muller,* 296 U. S. 207, 210; *Radio Station WOW, Inc.* v. *Johnson,* 326 U. S. 120, 129. This Court has made it a condition of jurisdiction that it "appear affirmatively from the record, not only that a federal question was presented to the highest court of the State having jurisdiction but that its decision of the federal question was necessary to the determination of the cause, and that it was actually decided or that the judgment as rendered could not have been given without deciding it". *Lynch* v. *New York ex rel. Pierson,* 293 U. S. 52, 54; *Klinger* v. *Missouri, supra; Southwestern Bell Telephone Co.* v. *Oklahoma,* 303 U. S. 206, 211-12; *Williams* v. *Kaiser,* 323 U. S. 474, 477-78.

Petitioner assures this Court that this condition is satis-

fied by repeatedly stating as a fact that the State Court reached its decision under the compulsion of the due process clause of the Fourteenth Amendment. (Pet. pp. 12, 13, 19, 22.) If that were true, there would be no question on this ground as to the jurisdiction of this Court. *Grayson* v. *Harris,* 267 U. S. 352, 358; *Virginia* v. *Imperial Coal Sales Co., Inc.,* 293 U. S. 15, 16-17. On the facts in the record, as correctly stated above at pages 3, 6 and 7, respondent believes there can be as little doubt as to the absence of jurisdiction.

Moreover we should like to emphasize that in its consideration of the various adjustments made by the Commission in the Company's revenues, expenses and investment, the State Court did not purport to decide what was "required" by either the federal or State constitutions, as petitioners would assume. There was no issue below concerning the application of the federal or State due process clauses or the interpretation of federal or State decisions construing them. The important question presented by the assignment of errors and the sole question considered by the State Court was whether the evidence in the record supported the Commission's action or that of the trial court. The State Court's opinion demonstrates clearly that it, like the trial court, found no evidence whatever to support certain of the Commission's adjustments, while others were found to be based upon out-and-out errors and omissions in testimony and computations.

The case presented by the record is therefore not the case of undoubted jurisdiction stated in the Petition. It is a case in which it does not appear either affirmatively or by inference that a federal question was decided by the highest court of the State and in which indisputably adequate State grounds, statutory and constitutional, were present. This Court has invariably refused to take jurisdiction on such a record. *Johnson* v. *Risk,* 137 U. S. 300; *Lynch* v. *New York ex rel. Pierson,* 293 U. S. 52; *Mc-*

Goldrick v. *Gulf Oil Corp.*, 309 U. S. 2; *Public Service Commission* v. *Wisconsin Telephone Co.*, 309 U. S. 657. The same result has followed even when the decision of the federal question has affirmatively appeared and it has been doubtful whether the judgment was also intended to be rested upon the decision of an adequate State question. *Herb* v. *Pitcairn*, 324 U. S. 117; *Minnesota* v. *National Tea Co.*, 309 U. S. 551; *New York City* v. *Central Savings Bank*, 306 U. S. 661.

State Tax Commission of Utah v. *Van Cott*, 306 U. S. 511, cited by petitioners,[10] is one of a few cases involving the question whether a State court rested its decision on an adequate State ground, in which this Court, while refusing to take jurisdiction, has found reasonable grounds for remanding for clarification of the opinion of the State court. These cases demonstrate the clear lack of jurisdiction here because the affirmative elements which this Court found necessary to justify even an inference that the State Court probably rested its judgment on a federal ground, rather than on an adequate State ground, do not appear in the record in this case. Here the State Court did not expressly decide a federal question at all. Cf. *State Tax Commission of Utah* v. *Van Cott, supra; Minnesota* v. *National Tea Company, supra; Herb* v. *Pitcairn, supra.* Nor is there a certificate of the State Court that a federal question was necessarily decided. Cf. *Honeyman* v. *Hanan*, 300 U. S. 14. There is no language in the opinion which indicates that the State Court considered a federal question. As stated above, the only mention of the Fourteenth Amendment appears in a quotation from the

[10] Petitioners also refer to the cases of *Abie State Bank* v. *Bryan*, 282 U. S. 765, 773 and *Coleman* v. *Miller*, 307 U. S. 433, 437. These cases are not in point. They both involve the question whether the ground relied upon by the State courts was one of federal or of state law. In both, this Court determined that a question treated by the state court as a state question was actually a federal question. There is no such problem here.

opinion in a case in which only a State question was raised. The State Court's opinion does not expressly refer to the federal cases cited therein as binding on it, nor does it refer to a duty to follow them. Cf. *Minnesota* v. *National Tea Company, supra,* 554. Neither the opinion herein nor any other opinion of the State Court indicates a possible State rule that the interpretation by this Court of the Federal Constitution controls that of the like clauses of the State Constitution. Cf. *Minnesota* v. *National Tea Company, supra,* 556.[11]

All that appears affirmatively in the opinion of the State Court is the citation of federal cases. It is obvious that, when state and federal questions before the court are substantially the same, this, standing alone, has no significance as an indication that a federal question is being decided. *Levy* v. *Superior Court of San Francisco,* 167 U. S. 175, 177. There must be some evidence of constraint to apply a rule which would not be applied by choice. Not only does the State Court's opinion contain no such indication, but it appears that that Court used the cases cited merely because they contained statements of principles relied upon by the petitioners and the Commission and not questioned by the Company. The State Court, like the trial court, found as to each disputed adjustment that the find-

[11] In the South Dakota opinion relied upon by petitioners in which the State Court noted the identity of language in the two constitutions, it clearly indicated that its adherence to the doctrine of the *St. Joseph Stock Yards* case, 298 U. S. 38, in determining questions of confiscation under the State due process clause is discretionary. *Application of Northwestern Bell Telephone Co.,* 69 S. D. 36, 45, 6 N. W. (2d) 165, 170. This would suffice to rebut any inference that the court felt itself constrained to follow the federal rule. Compare *Minnesota* v. *National Tea Co., supra,* 556, and *National Tea Co.* v. *State,* 205 Minn. 443, 286 N. W. 360, with *New York City* v. *Central Savings Bank, supra,* and *Central Savings Bank* v. *City of New York,* 280 N. Y. 9, 19 N. E. (2d) 659. The present case is on all fours in this respect with the *Central Savings Bank* case which this court distinguished in the *Minnesota* case.

ings of fact upon which the Commission's conclusion depended *were arbitrary and without support in the record;* as to each disputed adjustment, it held the findings upon which the trial court's conclusion depended to be sustained by the evidence.[12] The question of the merits of the holdings in the Federal cases cited was not even one which had to be considered by the State Court in the present case.

Thus it does not appear affirmatively that the State Court rested its decision on a federal ground and the record does not even present any grounds for an inference that the judgment probably rests on the decision of a federal question. In these circumstances it is respectfully suggested that the lack of jurisdiction is clear on the authorities cited.

III.

NO SUBSTANTIAL QUESTION IS PRESENTED BY THE PETITION BECAUSE THE DETERMINATIONS OF THE COURTS BELOW NOT PROPERLY ASSIGNED AS ERROR HAVE ESTABLISHED THAT THE COMMISSION'S ORDER WOULD RESTRICT THE COMPANY TO A RETURN OF LESS THAN 3% ON ITS NET INVESTMENT.

Even assuming that the petitioners could adopt here as their own the assignments of error filed in the State Court by the Commission, certain findings and determinations of the trial court in this proceeding were not assigned as error in the State Court by any party. These findings and determinations of the trial court were not reviewed by the State Court because, in a legal sense, they were conceded to be correct by both the Commission and the petitioners as appellants before that Court. Such findings and de-

[12] This was in entire accord with its ruling in a prior decision where there was in issue only the validity of a Commission order under State law. *In re Application of Northwestern Bell Telephone Co.*, 69 S. D. 36, 6 N. W. (2d) 165.

terminations of the trial Court may not, therefore, be disputed in this Court. *Wilson* v. *Cook,* 327 U. S. 474, 483-84; *West Ohio Gas Co.* v. *Public Utilities Commission of Ohio* (No. 1), 294 U. S. 63, 76.

Other conclusions of the trial court were assigned as error in the State Court, but its determinations thereon are not specified as error by the petitioners in this Court. These determinations likewise are not subject to dispute in this Court. Rule 38, Supreme Court Rules; *General Talking Pictures Corp.* v. *Western Electric Co.,* 304 U. S. 175, 177-79; *National Licorice Co.* v. *National Labor Relations Board,* 309 U. S. 350, 357.

The findings and determinations which thus stand unchallenged in this Court are sufficient in themselves to establish beyond question the confiscatory nature of the Commission's order. The trial court found that the Commission had erroneously failed to give any recognition to the wage increase amounting to $211,768 annually in 1948 (R. 253.); had failed to make any allowance for the payment of federal income taxes in computing the Company's income available for return (R. 253.); and had arbitrarily reduced the book cost of the Company's plant for rate base purposes in the amount of $428,427 because of alleged excessive Western Electric profits.[13] (R. 253, 255-56.) None of these findings of the trial Court was assigned as error in the State Court. (R. 265-68.)

The trial court also found that the Commission had arbitrarily reduced the Company's annual maintenance expenses $80,000 because of alleged deferred maintenance (R. 258.); had overstated the Company's 1948 revenues by $92,949 (R. 258.); and had erroneously rejected the

[13] The Commission did not assign as error the trial court's rejection of its adjustments in the rate base on account of profits of Western Electric in prior years; it confined its assignment to the rejection of the adjustment in expenses for 1948 on this account. (R. 265-66.)

Company's costs of metallicizing in the amount of $401,293. (R. 253, 256.) These latter findings of the trial Court were assigned as error by the Commission (R. 267-68, 268, 266.) but the determinations of the State Court thereon are not specified as error by the petitioners here.

Reversing the Commission's adjustments of the Company's net income available for return and rate base to remove only these conceded errors results in a correction of the Commission's estimate of net income and rate base to $329,165 and $12,012,373, respectively. This results in a return of only 2.74%, less than one half the 6% return found by the Commission to be reasonable, and even less than the rate of interest of 3.22% the Company was paying on its bond issue sold on the open market in November, 1948. (Com. Tr. p. 1494.) The details and effect of these adjustments and their reversal are shown in the Appendix at page 31 of our brief.

Any Commission order that restricts a utility to rates producing a return even less than the interest rate on its bonded indebtedness is so patently confiscatory as to present no substantial federal question. This Court will not review a judgment of a state court where no substantial federal question is presented. *Consolidated Turnpike Co.* v. *Norfolk & Ocean View Ry. Co.*, 228 U. S. 596; *Honeyman* v. *Hanan*, 300 U. S. 14, 23, 25; *Bailey* v. *Anderson*, 326 U. S. 203, 205.

IV.

THE DETERMINATIONS OF THE STATE COURT WHICH ARE SPECIFIED AS ERROR BY THE PETITIONERS ARE NOT IN PROBABLE CONFICT WITH APPLICABLE DECISIONS OF THIS COURT.

If it be assumed that the determinations made by the State Court on the Commission's assignments of error which are specified as error by petitioners are properly before this Court, analysis of the State Court's opinion will demonstrate that they are not in conflict with any decisions of this Court. These determinations have to do with the Commission's adjustments respecting (1) the separation of expenses between intrastate and interstate operations, (2) depreciation expense, (3) pension expense, (4) license contract expense, and (5) charges to expenses (not capital account) on account of purchases from Western Electric.

Separation of Expenses.

The trial court set aside the finding of the Commission on the separation of the Company's expenses between intrastate and interstate operations on the ground that it "is not supported by the evidence, is arbitrary and unwarranted." (R. 234, 257.) The State Court affirmed that judgment. (R. 360-A.)

In its opinion herein the trial court said:

> "The record discloses that a joint committee consisting of the Federal Communications Commission and the National Association of Railroad and Utilities Commissioners, of which South Dakota Commission was and is a member, was formed in 1941 to develop suitable separations procedures and principles and that after a series of conferences and studies a so-called separations manual was developed. A copy of this manual with amendments was offered and re-

ceived in evidence as a part of Exhibit 5; this manual consists of 87 printed pages. The testimony shows that appellant in making its separation followed the method prescribed by this separations manual. There seems to be no contention that this was not done." (R. 231-232.)

Pursuant to the method of separation thus established and in general use throughout the country, the Company offered exhaustive evidence showing the portion of its revenues, expenses and plant allocable to its South Dakota intrastate operations.[14] (Com. Tr. pp. 93, 97-98, 103-05.) The evidence proved that 80.2% of its expenses, 77.77% of its plant, and 77.56% of its revenues were chargeable to the operations here involved. (R. 65, 256-57.) The Commission accepted without question the Company's allocation as to plant and revenues but rejected its determination of its intrastate expense. (R. 65.) The Commission held, without any supporting evidence whatsoever, that the percentage of expense chargeable to South Dakota intrastate operations should be exactly the same as the percentage of plant so charged. (R. 65.) It is plain that this finding of the Commission was based solely upon an intent arbitrarily to reduce the Company's intrastate expenses.

The Commission objected in the State Court that under the finding of the trial court it was bound to accept the Separations Manual in determining the separation of plant,

[14] Petitioners' contention that the separations formula employed by the Company was one developed by American Company technicians is thus a complete misrepresentation, as is their claim that the formula was employed for "plant use" only and not for the separation of revenues and expenses. Likewise, petitioners' reference (Pet. p. 14) to the use of studies made in certain other States in connection with one phase of the separation is characteristic of their effort to create and argue issues here which were not decided below. The Commission made no reference to such a point in its report, or in its briefs in the trial court. Neither was it assigned as error in the State Court, and it thus never became an issue below.

revenue and expenses. (R. 266.) The State Court, however, recognized that the Commission was not bound by the Separations Manual as such merely because it was developed in part by representatives of the Federal Communications Commission. (R. 360-A.) The State Court nevertheless held that the action of the Commission must be based upon evidence and sustained the judgment of the trial court that the Commission's adjustment of the Company's separation of expenses "is not supported by the evidence, is arbitrary and unwarranted," (R. 234) stating as follows:

> "The expenses attributable to intrastate operations may not, however, be arbitrarily fixed. As has been pointed out 77.77 per cent of the Company's property in this State was devoted to intrastate use. It may not be assumed, without findings based upon evidence, that such percentage is also the proper basis for allocating operating expenses." (R. 360-A.)

The record sustains the holding that the assumption by the Commission that the ratios of intrastate expense and intrastate property must be the same is unsupported by any evidence. The determination by the State Court that it must reject such a finding is not contrary to pronouncements of this Court. Petitioners cite the case of *Colorado Interstate Gas Co.* v. *Federal Power Commission,* 324 U. S. 581. In that case the court found that the Commission's allocation was based upon a reasonable premise fully supported by competent evidence. Nothing in that decision indicates a Commission finding must be adjudged valid when it is arbitrary and unsupported by evidence. The State Court has consistently held through a long period of years that it has the power and the duty to set aside orders of the Commission which are not supported by substantial evidence and thus constitute purely arbitrary action. *Application of Dakota Transportation, Inc., of Sioux Falls,* 67 S. D. 221, 291 N. W. 589; *Application of Northwestern Bell Telephone Co.,* 69

S. D. 36, 6 N. W. (2d) 165. Clearly such a ruling does not conflict with federal law.

Depreciation Expense.

The petitioners argue that the Commission attempted to challenge the Company's depreciation expense but that the State Court denied the challenge solely for the reason that the Company had shown its accounting methods to be in strict accordance with those prescribed by the Federal Communications Commission. They seem to contend further, in a somewhat confusing manner, that the Company's depreciation reserve was excessive, and that from this it follows that the depreciation accumulations were not calculated to keep its investment unimpaired, but to secure additional plant on which to gain a return, contrary to the decision in *Lindheimer* v. *Illinois Bell Telephone Co.*, 292 U. S. 151. Each of these assertions is erroneous.

Petitioners say "The company's burden of proof that its depreciation rates are not excessive is not met by showing that its accounting methods are correct." (Pet. p. 15.) No such contention ever was made. There was no dispute as to accounting methods. The Commission found, as stated in the opinion below:

> "The applicant figures its depreciation by the so-called straight line method, which is prescribed by the Federal Communications Commission, and has been generally accepted by this Commission." (R. 66-A.)

But the Company's proof went far beyond a mere showing that it had complied strictly with the accounting requirements. It included testimony, based on studies, showing the average life and salvage value of each of the classes of plant and the annual rates of depreciation computed therefrom. (Com. Tr. pp. 218-25; Exs. A-11, A-98, Com. Tr. pp. 225, 1949, 1294, 2372.) When applied to the

Company's investment in each class of plant these rates established the depreciation expense for 1948. The Commission rejected this proof and relied instead on testimony of the witness Quinney, as a result of which it reduced this item of expense. (R. 67-68.) In discussing this reduction, the State Court quoted with approval the language of the trial court, which had pointed out two major errors in the witness Quinney's exhibit P-90 and Supplement as "errors which distorted his computations." (R. 247.) These gross infirmities completely destroyed the value of this exhibit and testimony as evidence of the Company's depreciation expense for 1948. The finding of the Commission was therefore unsupported by competent evidence and the State Court accordingly rejected its disallowance of the Company's proved depreciation expense. (R. 370.)

For the obvious purpose of laying a foundation for a claim that the principles of the *Lindheimer* case apply, petitioners assert that the Company's depreciation reserve was excessive. They offer in support only the statement that the Company's own evidence shows "that grossly excessive funds have been accumulated in its depreciation reserves," and cite only Exhibit A-135 (Com. Tr. pp. 1904, 2649) in support of this allegation (Pet. p. 16). This exhibit merely shows the ratio of the Company's depreciation reserve to the book cost of its depreciable plant for each of the years 1937 to 1948, inclusive.[15] Nothing therein indicates whether or not the Company's depreciation reserve was excessive, insufficient or proper.[16]

---

[15] Exhibit A-135 shows that this ratio as of the latest date available, December 31, 1948, was 29.60% as contrasted to the 39.46% mentioned by petitioners.

[16] The Commission's assignments of error in the State Court did not raise any question concerning the Company's depreciation reserve. (R. 267.) In its opinion that Court states "* * * we are not in this proceeding invited to pass upon the correctness or validity of the Company's depreciation reserve built up during years of service of the utility in this state prior to 1948." (R. 365.)

However, even if the reserve were excessive, the principles of the *Lindheimer* case would not apply here, for the reason that the full amount of the reserve was deducted in arriving at the rate base. In the *Lindheimer* case the Illinois Company took the position that depreciation to be deducted in arriving at the rate base was an amount very much smaller than the depreciation reserve. It was this disparity which caused this Court to make the observation cited by petitioners that if charges to depreciation are excessive they require the subscribers to make capital contributions to the enterprise, upon which the utility expects a return. No such disparity is present here, because the full amount of the Company's reserve was deducted in the computation of the rate base. (R. 365.) Consequently, no contribution of the subscribers to the depreciation reserve can possibly be a part of the capital on which the Company receives a return.

The determination of the State Court on the issue of depreciation expense is not at variance with the applicable decisions of this Court.

Pension Expense.

The Commission disallowed as proper operating expense the excess of the Company's annual pension accruals paid to the trustee of the pension trust fund over the amounts paid to pensioners by the trustee during that year. (R. 72.) The State Court held that the decisive question was whether the present pension system is sound and not an unfair burden to those who pay for the use of telephones. It found the Company's pension system sound and the charges to expense not excessive. (R. 372.) It quoted with approval the statement of the trial court that the money represented by the annual pension accruals paid to the trustee is immediately and permanently beyond the reach of the Company. (R. 372.)

The petitioners point out that current pension accruals were more than five times current pension payments (Pet. pp. 4, 7), but they make no mention of the fact that the Company had more than doubled both its employee force and its average wage rates in the past ten years. (Com. Tr. p. 937; Ex. A-8, Com. Tr. pp. 112, 1929.) Under the Pension Plan, no employee is eligible to receive pension payments until he has 20 years service and the amount of the pension is based on the average wage for the ten years preceding retirement. (Ex. A-48, Com. Tr. pp. 593, 2195.) Consequently, under the actuarial accrual method, recent increases in the number of employees and in wage rates are reflected immediately in the dollar amount of pension accruals, but not in the amount of pension payments. By ignoring these facts petitioners attempt to distort the significance of the comparison between current pension accruals and pension payments.[17]

The actuarial accrual method adopted by the Company is a well recognized method of meeting pension expense, and is based upon the same principle as that used by life insurance companies in creating their reserves. There is no evidence that the Company's adoption of this method, or its determination of the amount of the annual pension accruals required thereunder was improper.

It is the settled law that in calculating a company's net income in a rate case, the company's actual expenditures must be recognized unless there has been an abuse of managerial discretion in incurring them. Statements that a utility's expenses must be reasonable do not impinge upon

[17] The petitioners also state the record demonstrates that it will probably be 75 years before the pension payments equal pension accruals. (Pet. pp. 4, 18.) The record does not support that assertion. The Company witness was asked when the pension disbursements would equal the pension accruals. He replied he could not make even a guess because the future contains too many unknowns such as growth in number of employees, change of wage rate level, etc. (Com. Tr. p. 931.)

this rule. It would be an abuse of discretion to incur unreasonable expenses. The point is that where there is room for reasonable difference of opinion as to whether expenditures should be made, or as to their amount, the discretion of the management must be accepted. Expenditures made within its reasonable discretion must be recognized in full. The regulatory body is not the manager and is not empowered to substitute its judgment for that of the management. *Missouri ex rel. Southwestern Bell Telephone Co.* v. *Public Service Commission*, 262 U. S. 276, 289; *West Ohio Gas Co.* v. *Public Utilities Commission (No. 1)*, 294 U. S. 63, 72; *Banton* v. *Belt Line Ry.*, 268 U. S. 413, 421. No new question is presented to this Court by the determination of the State Court on this issue and it is not pretended that the opinion below is in conflict with applicable federal law.

License Contract Expense.

Petitioners' argument on this subject rests on the implication that the State Court held that the Commission might not inquire into the cost to the American Company of the license contract services rendered to the Company. This implication is contradicted by the language of that Court.

The State Court adopted as its own the language of the trial court on license contract expense. (R. 361-A.) That court had stated:

> "In the earlier cases the only legitimate inquiry was considered to be whether the operating company was getting value received. * * * In *Smith* v. *Illinois Bell Telephone Company, supra* [282 U. S. 133], the Court went further and held that the cost to the American Company of rendering the license services were proper matters of inquiry." (R. 363.)

The State Court thus adopted the rule, contended for by the Commission and not disputed by the Company, that the Commission could inquire into the costs of the American Company.

Applying this rule, the trial court found that under the undisputed evidence in the record the cost to the American Company in rendering license contract services applicable to South Dakota exceeded the payments therefor by the Company. (R. 363.) It also quoted extensively from testimony of a Company witness which indicated the value to the Company of the license contract services rendered by the American Company. (R. 362-63.)

The Commission itself had found the Company's evidence insufficient only because the expense was "allocated" to South Dakota operations. (R. 73.) As to this the Court said:

> "From the very nature of the services rendered it must be apparent that it is impossible to exactly fix the value of each item of the services rendered, but the method used in this case clearly satisfies the requirements of the case of *Smith vs. Illinois Bell Telephone Company, supra.*" (R. 364.)

The Court quoted the applicable language of this Court in the *Smith* case, wherein it was said at page 157:

> "In view of the findings, both of the state commissions and of the court, we see no reason to doubt that valuable services were rendered by the American Company, but there should be specific findings by the statutory court with regard to the cost of these services to the American Company and the reasonable amount which should be *allocated* in this respect to the operating expenses of the intrastate business of the Illinois Company in the years covered by the decree."

Having found the disallowance by the Commission of all license contract payments to be arbitrary and contrary to law, the State Court upheld the payments on the basis of the undisputed evidence in the record as to the value

of the license contract services to the respondent (Com. Tr. pp. 282-301) and the amount of the total license contract costs of the American Company allocable to South Dakota operations. (Com. Tr. pp. 345-99; Ex. A-55, Com. Tr. pp. 779, 2277.)

The action of the State Court was consistent with the rule of law stated in the *Smith* case and was required by the evidence before it. As shown above, the Company made a full and complete showing as to the costs of the American Company in rendering license contract services applicable to the Company's South Dakota operations on the basis of which the Court made findings. Consequently, the decisions of this Court cited by petitioners are not in point on their facts and do not support petitioners' contentions.

Western Electric Profits.

The State Court held that the Commission's adjustment of the Company's operating expenses on the ground that excessive profits were received by Western Electric on its sales of materials and supplies purchased by the Company, was not based on substantial evidence and was therefore arbitrary. (R. 360-A.) Quoting from the opinion of the trial court, it noted the corporate affiliation between the Company and Western Electric, recognized as sound the principle stated in *Smith* v. *Illinois Tell Telephone Co.*, 282 U. S. 133, and concluded that it was incumbent upon the Company to show not only that prices charged by Western Electric were reasonable as compared with the prices of others, but also that the profits of that company upon its sales to Bell System Companies were reasonable. (R. 360-A.) This holding could not, of course, be prejudicial to the rights of petitioners.

The trial court held on the evidence before it that the materials purchased from Western Electric had been ob-

tained at lower prices than if they had been purchased from other manufacturers, and that the profits of Western Electric from these sales were not excessive. (R. 222, 223.) The court found moreover that the calculations on which the Commission based its adjustment were so grossly erroneous as actually to deny Western Electric any profits whatsoever on these sales. The trial court found: "* * * the Commission simply assumes that all profit made by Western Electric on sales to appellant during the years 1947 and 48 were excessive profits and deducts the entire amount." (R. 224.)[18]

The assertions of the petitioners concerning this adjustment by the Commission constitute a misstatement of the record. They indicate that the Company failed entirely to make any showing as to Western Electric's profits on its sales to the Company. On the contrary, the Company presented proof on this subject in great detail both by testimony and exhibits. (R. 361; Ex. A-36, Com. Tr. pp. 466, 2055.) None of the authorities cited by petitioners (Pet. p. 22.) are in point, and none suggest that the reviewing court must sustain findings of the Commission which are not only unsupported by any evidence but contrary to convincing and undisputed evidence.

[18] The Commission's own statement on this point clearly reveals this error. (R. 76-77.)

CONCLUSION.

It is respectfully submitted that petitioners have no standing in this Court, that the decision of the State Court did not depend upon the determination of a federal question, that the unchallenged findings are sufficient alone to support the State Court's judgment, and that the determinations of that court, based upon findings that the Commission's order is not supported by evidence, are not in conflict with any decisions of this Court.

HARRIS A. POLEY,

DOUGLAS F. SMITH,

RICHARD L. SELLE,

Attorneys for Respondent.

T. J. PEYCKE,
SIDLEY, AUSTIN, BURGESS & SMITH,
Of Counsel.

Dated: January 15, 1951.